



The Federal Report

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

The Month in Washington: March 2006

The last 30 days have reaffirmed old rules of Federal politics concerning the ability of a President with declining popularity to hold Congressional allies in line as they face an election which he does not. After cresting in Congressional influence with the successful nominations of two Supreme Courts Justices whose influence will be felt in the judiciary for decades to come, Mr. Bush has experienced several reversals which, according to many on both sides of the aisle, seem to have sapped his Congressional clout.

When the public learned of the proposal to transfer ownership of several U.S. ports to a company headquartered in the United Arab Emirates, Congressional Republicans joined with other deal critics to scuttle the plan despite a threatened veto from the White House. While the fight is far from won, recent Congressional discussions on the Medicare Part D drug benefit also broke with the Administration's position as the Senate both granted the Health and Human Services Secretary the authority to extend the enrollment deadline and approved an amendment to the budget resolution making it easier to eventually permit the HHS Secretary to negotiate drug prices with providers. The divisive immigration measure now on the Senate floor has showcased proposals by 2008 GOP hopefuls Bill Frist (R-TN), John McCain (R-AZ), and other players that often ignore the Administration's wishes for the bill, such as the President's insistence that there be a functional guest worker program. Although the Senate may ultimately adopt some type of a guest worker program, the House has ignored the President's wishes and enacted a version of immigration reform which is silent on such a measure.

A widely reported March 15 poll by the Pew Research Center for the People and the Press found the President's approval at 33%, with losses among Republicans, Democrats, and Independents since January. This decline in the perceived strength of the White House makes it difficult for the Administration to pull legislation toward its position when the public favors another outcome. Such a dynamic will likely only intensify as the November elections draw closer, potentially affecting pending measures on immigration, the budget, and pension reform where the President has put down policy markers which many legislators believe they have diminishing reason to adopt.

Issues and Events

Pension Conference Shows Congressional Difficulties

The long delays starting the conference on pension reform legislation (S.1783 and H.R. 2830) show the problems which can occur in moving even popular legislation through the process. After both chambers passed their versions of pension reform by substantial

margins late last year, a disagreement in the Senate prevented the appointment of conferees for many weeks. In mid-March, the Senate leadership finally settled on representatives for the conference with the House, creating an unusually large group of 27 conferees to hammer out differences in the legislation. The House version of pension reform includes the permanent extension of expiring provisions of EGTTTRA helpful to public plans, such as increases in the dollar limits for 401(k), 457, and 403(b) plans; improvements in the catch-up provisions; and increases in the annual benefit limit for qualified defined benefit plans, all of which will disappear in 2010 if not made permanent.

Not surprisingly, most sources report slow progress on the conference. Its sheer size makes compromise among staff problematic and creates additional delays that make dealing with time pressures all the more difficult. As the perceived pressures build, corners can sometimes be cut in getting legislation finished on time. In the case of pension reform, the measures drawing the greatest public interest involve the solvency of private defined benefit plans, particularly those in the volatile airline industry. These plans must make their first quarterly payments by April 15, and rumors that some other troubled plan may terminate soon and dump billions of dollars in new liabilities on the Pension Benefit Guarantee Corporation further inspires Congress to act quickly. Another problem is the approach of the November elections which are already beginning to exert their own pressures on Capitol Hill. A report at the end of March suggested that the stalled conference may now be aiming for a resolution sometime in May.

A typical reaction to deadlines is to simply drop contentious provisions, a troubling pattern for public plans since renewal of the expiring EGTTTRA pension measures are found only in the House bill and may thus be in some danger if the conference drags on past the expectations of the leadership. Majority Leader John Boehner (R-OH) announced that he hopes to have the pension legislation done in early April. Should the resolution of conference slip past that time, the EGTTTRA provisions and other measures not contained in both bills may be in jeopardy.

Maneuvering Continues on Drug Benefit

Democrats seized on the imminent May 15 cut off for enrollment in the Medicare Part D Drug Benefit program to blast the expansion of Medicare as complex, badly designed, and too favorable to providers. Both sides of Capitol Hill and both parties took action on addressing the issue, with reformers scoring a pair of victories in the Senate during the final days before the March 17 recess.

An amendment to the budget resolution granted the Secretary of Health and Human Services (HHS) the authority to extend the enrollment time period if deemed necessary. Some legislators claimed that the Secretary already had this ability while others still feel that an amendment to the non-binding budget blueprint is not enough to grant legal power. A previous proposal to direct the Secretary to change the deadline regardless of the Administration's feelings on the matter failed on a tie vote before the Senate adopted this compromise 76-22.

The second development on Medicare Part D came when Senators Ron Wyden (D-OR) and Olympia Snowe (R-ME) won a close vote on their amendment to the budget resolution which would permit the removal of the law's current ban on the HHS Secretary's negotiating prices with drug providers, with any savings to be used for deficit reduction or to improve the Part D benefit. Although the amendment does not directly permit the Secretary to negotiate, winning this amendment in the budget resolution provides procedural protection to any legislative change made later on this subject. Because Senate rules allow points of order to be raised against legislation with a budgetary effect that is not accounted for in the budget resolution, this bipartisan win on the drug pricing amendment puts a future push on the measure on favorable parliamentary footing.

The White House thus far remains committed to the May 15 deadline despite the fact that many millions of seniors have yet to select a plan and it opposes any negotiating role for the Federal government regarding drug prices for Medicare. The two Senate votes can be seen not so much as an attempt to force policy changes but, at least at present, to place markers of Senate sentiment on the issues and transfer political liability from the Senate to the White House for any future meltdown of Medicare D benefits.

Controversy Continues on Sarbanes-Oxley, Sec. 404

On March 3, the Securities and Exchange Commission (SEC) released a discussion draft of its almost-final findings regarding the 2002 Sarbanes-Oxley Act. The Commission's recommendations come from the Advisory Committee on Smaller Public Companies, which was established to look at various issues including financial reporting, corporate governance requirements, accounting standards, rules on public offerings for smaller companies, and even an appropriate definition for the term "smaller companies."

The Committee calls for a system of "scaled or proportional securities regulation" for microcap and smallcap entities (meaning companies with the lowest 6% of U.S. equity capitalization, currently \$787.1 million or less). The report notes that these two classes of entities represent more than 78% of all U.S. public companies. Under the Committee's top proposal, these small companies would be exempted from Section 404's requirements for companies' annual reports to publicly evaluate their oversight structure and examine their financial reporting with an external audit if these small companies establish audit committees meeting certain standards and adopt an ethical code.

Controversy continues over whether or not the SEC has the authority under existing statute to implement the suggestions of the Advisory Committee or if instead it must seek legislative approval from Congress. A letter from Congressman Michael Oxley, Chairman of the House Financial Services Committee, and Congressman Richard Baker, Chairman of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, asserts that the SEC already possesses the authority to execute rules based on the Committee's report.

Other groups hold the opposite view, as does Senator Sarbanes. In a speech before the Consumer Federation of America on March 23, Sarbanes openly questioned the legality of the SEC altering the Sarbanes-Oxley law to implement the Advisory Committee's findings and opposed such a move as bad policy. "Focusing only on larger companies may fail to target companies with greater risk for financial statement fraud activity," he said. Further, he said, studies have shown that typical companies involved in SEC enforcement cases are very small.

The CalPERS Board of Administration met with SEC Chairman Christopher Cox, Commissioner Campos, and Congressman Baker during their trip to Washington, DC, this month to discuss the System's concerns about efforts to weaken or overturn the Sarbanes-Oxley Act. They also spent time with Sarbanes and his staff to reaffirm CalPERS' strong support for the integrity of the Sarbanes-Oxley law.

California Congressional Delegation

New Leadership Coming to Crucial House Committee

With the powerful tax-writing Ways and Means Committee getting a new chairman next year, the CalPERS Board of Administration met with the reported front-runner for the post, Congressman Jim McCrery (R-LA), during its business meeting in Washington, DC, this month. McCrery currently chairs the Ways and Means Subcommittee on Social Security and is one of the most senior members on the Ways and Means panel.

The Ways and Means Committee holds jurisdiction over healthcare, including part of Medicare, and the tax laws which define a qualified pension plan. The Board offered CalPERS' expertise as the third largest U.S. purchaser of health insurance and its experience as the nation's largest public pension fund to assist the Congressman as health and retirement issues come before the Committee in the future.

Current Ways and Means Chairman Bill Thomas (R-CA, Bakersfield) announced this month that he would retire at the conclusion of the current Congress. Facing the end of his term as Chairman because of reform rules adopted by House Republicans, Thomas saw that there was little left that he could realistically accomplish, according to Representative Devin Nunes (R-CA), and declared his intention to retire. Other possible successors to Representative Thomas as Chairman include Nancy Johnson (R-CT), and Clay Shaw (R-FL).

Miller Scores Instruction Victory

During consideration of the motion to appoint conferees on the pension reform bill, House Education and the Workforce Ranking Minority Member George Miller (D-CA, Richmond) offered an amendment to direct the House's negotiators to take several positions in the conference with the Senate.

Congressman Miller told his colleagues that any new requirements for private plans to pay additional insurance premiums to the Pension Benefit Guarantee Corporation (PBGC) must strike a careful balance. Those plans which are not at risk should not be forced to pay an additional premium so high that terminating their plans seems the better choice. The motion to instruct included other directives favorable to airline pilots and a provision to allow taxpayers to directly deposit a portion of their refunds into savings accounts. Representative Miller convinced 264 of his colleagues to agree with his motion, while 158 voted against it. Those who spoke against the Miller Amendment opposed the measure less on policy grounds than on philosophical objections to binding the options of the conferees.

Pelosi, Democratic Leaders Charge on Medicare D

House Minority Leader Nancy Pelosi (D-CA, San Francisco) took a prominent position in leading the Democratic criticism of the Administration's position on the deadline to enroll in the Medicare Part D benefit. She joined Energy and Commerce Committee Ranking Minority Member John Dingell (D-MI), and Ways and Means Committee Ranking Minority Member Charles Rangel (D-NY) in calling for an extension to the deadline. Calling the plan "flawed," "complex," and "needlessly complicated," the Democratic leaders urged the Administration to quickly announce a delay or ask Congress to act. An effort to extend the enrollment deadline failed on the House floor Thursday, March 16, on procedural grounds during consideration of the budget resolution but the Senate made some progress on the issue (see story above).

Related National and Industry News

New Doubts on Stand-Alone DC Plans

A recent survey by Aon Consulting revealed deep skepticism among employers that their workers will be able to retire with adequate assets at a normal retirement age of 63 to 65. While 74% of those surveyed said they offered a defined contribution plan of some sort, the most telling result of the poll was that only 19% of surveyed companies believe their workers actually understand how to invest. Insufficient contributions up front and failure to invest correctly may explain why only half of older workers' 401(k) accounts are funded well enough to pay about \$5,000 per year in retirement, according to the Congressional Research Service, while the average public DB sector plan pays \$19,800 annually.

Despite the broad acceptance among pension experts that DC plans were intended to supplement, not supplant, defined benefit plans, new proposals to replace public plans with 401(k) or hybrid type plans continue to appear seemingly every week. In a speech in late February, even a financial expert such as Chicago Federal Reserve President Michael Moskowitz suggested replacing public DB plans with DC plans, despite any evidence that DC plans alone have ever provided adequate retirement income to any substantial percentage of the retiring population. Paul Zorn of Gabriel, Roeder, Smith and Company joined with Keith Brainard of NASRA to reply to Mr. Moskowitz in a March

15 letter challenging Moskow's broad criticisms of public plans in several areas including funding and ERISA standards. The public plan letter asserts that the level of retirement income provided to the soon-to-swell ranks of an older workforce will determine whether retirees will be able to contribute to sustained growth or, by implication, will instead require support from the diminishing pool of active workers.

Illinois Ills Preview Darfur Dilemmas

Institutional Investor recently ran a story on the troubles which the Illinois public systems have encountered in complying with State legislation passed last year ordering public money out of companies with a financial tie to Sudan. The article cites the lack of legal distinction between the many sorts of financial instruments used, lumping them all under "forms of investment securities" when setting standards for disclosure and transparency.

Executives interviewed for the story considered the legislative details (or lack of them) problematic. The requirement for uniform transparency for all securities made more complex versions such as private equity uncompetitive because of disclosure requirements; the virtually nonexistent regulatory environment of Sudan complicates a directive to identify Sudanese investments; and, as U.S. firms are already banned from direct presence in Sudan, the law requires a vaguely defined expert to sift through the various levels of transparency found throughout the world's corporate regulations to determine which foreign companies have the requisite level of contact with Sudan.

The article highlights the troubles which arise for public plans not from poor policy but rather from unspecific and vague legal requirements which are developed without input from the experts who must ultimately comply with them.